

Guest editorial: Building COVID-19 resilient insolvency frameworks

1 | STAY HOME, STAY SAFE

At the time this guest editorial was written, the world has faced an unprecedented course of events with the outbreak of the COVID-19 (corona) virus. In a short time, this virus has reached pandemic status with cases of corona infections reported on all continents. Justified by the medical urgency, governments have prompted extraordinary measures to stop its spreading. Under the phrase “stay home, stay safe”, physical contact must be prevented, people should work from home, but also, businesses are closing down and cities and sometimes countries are in lockdown. These measures aim to protect the lives of many. However, the economic consequences of both the spread of the virus and public health measures cannot be overlooked. In a matter of weeks, large parts of the global economy have experienced a major slow down or effectively a shut down. This viral crisis extends beyond human lives, impacting also the livelihood of many businesses, their entrepreneurs and employees.

Economic uncertainties remain high these days. It is unclear to what extent the spread of the virus must be under control before market activities are allowed to resume. It is uncertain as to how long it will take before a vaccine will be available. The duration of current measures is unknown and impossible to calculate *ex ante*. Additional measures imposed for public health reasons are not yet precluded. The situation directly impacts businesses of all sizes and throughout various sectors. It hits both already troubled and healthy companies. A greater number of businesses, especially those of micro-size, are closed for weeks with no or little revenue. The lockdown also hits larger companies, in particular in sectors connected to leisure and travel or depending on constant supply of goods from or to abroad. At a macro level, a global recession has already been forecast, impacting the economy in the months, year or even years coming.

The current shock has the peculiar effect that many companies with a viable and sound business model at the beginning of 2020 are suddenly confronted with imminent insolvency and may be obliged or at least prompted to file for insolvency proceedings. Here, insolvency practitioners and courts face new challenges. Going-concern assessments are burdened with the uncertainty of a global crisis and cause debtors to suffer a piecemeal liquidation. Under current distressed market conditions, there is a significant risk of sales at an under value, restricting the ability of procedures to maximise value for creditors. The filter function of insolvency frameworks, functional in normal market situations, cannot work as designed and produces an unnecessary amount of liquidations as a consequence of the exceptional economic situation caused by the COVID-19 crisis. Temporary adjustments are indicated.

2 | CONFERENCE ON EUROPEAN RESTRUCTURING AND INSOLVENCY LAW

In Europe, the Conference on European Restructuring and Insolvency Law (CERIL) has called upon legislators to urgently amend insolvency legislation in response to the global economic consequences of COVID-19. CERIL is an independent non-profit, non-partisan, self-supporting organisation of approximately 75 lawyers and other restructuring and insolvency practitioners, law professors and (insolvency) judges. It is committed to the improvement of restructuring and insolvency laws and practices in Europe, the European Union and in its Member States.¹

From its inception, CERIL has been a voluntary organisation, based on the shared commitment by its members (conferees) to collect and present their best insights. In recent years, CERIL has established a platform that allows for the exchange of ideas, in-depth discussions, often in the context of joint studies and statements of advice on technical and policy matters. In its work, CERIL employs both comparative and international approaches. CERIL may also support legislative initiatives on a European Union or national level, but also discusses fundamental principles and concepts. CERIL has welcomed collaborations with several organisations, including the International Insolvency Institute and the European Law Institute.

CERIL organises its work primarily via topical Working Parties. Since 2017, their work has resulted in seven statements on topics such as transaction avoidance laws and value extraction schemes, implementation of the European Insolvency Regulation recast (2015) in national procedural law, cross-border insolvency post-Brexit, the UNCITRAL Model Law on Enterprise Group Insolvency and COVID-19.²

3 | COVID-19 AND ADAPTING INSOLVENCY LEGISLATION

The COVID-19 crisis has prompted governments across the globe to close borders and impose lockdowns in various shapes and forms. It usually only took a few days to realise that this will impact the business activity significantly and for a longer period of time. A foreseeable spike in the number of bankruptcies has led some legislators to consider and enact insolvency-related emergency legislation, often in conjunction with extraordinary state aid initiatives. These rules are vastly different both in content and projected lifetime. A systematic approach was missing. In response to this specific legislative challenge, the Executive of CERIL published recommendations to extend COVID-19 measures by amending insolvency legislation.

In its Executive Statement 2020–1,³ CERIL suggests that two steps should be taken immediately by European national legislators. First, the legislator should suspend the duty to file for insolvency proceedings based on the over-indebtedness of debtors. This duty exists in several EU Member States, including Austria, Germany, Greece, Italy, Latvia, Poland, and Spain. The current economic uncertainty hampers the effectiveness of such duties. This test to select non-viable businesses does not provide reliable results. In response, in some countries this duty has readily been amended, as was the case in Austria or Germany (where the duty to file was temporarily suspended). Second, in response to a (partial) shutdown of businesses for a number of weeks or months, urgent measures are required to address the resulting illiquidity of businesses. Businesses are in dire need of a quick solution to address the temporary lack of financial means to meet obligations that still fall due.

To assist national legislators, four additional measures have been recommended to assist those businesses and entrepreneurs in distress:

- 1 Amendments to insolvency legislation should make available interim (crisis) finance. This should allow debtors to bridge the time until normal market conditions return. However, for smaller businesses, additional credit may not be a useful option given their existing levels of debt.
- 2 The duty to file based on inability to pay should be suspended. Similar to the duty to file based on over-indebtedness, this duty is designed to select those debtors that are unviable. In the current economic situation, it does not provide for reliable results. Examples of measures in this regard have been taken in Spain and Germany.
- 3 The measures taken by national legislators should allow for “*hibernation*” (going into winter sleep) of (small) businesses. In the absence of sufficient cash flow and business activity, measures like a general moratorium or the deferral of payments will provide a business with a temporary breathing space. In this regard, guidance can also be found in Articles 6 and 7 of the EU Preventive Restructuring Directive (2019/1023) that provides for provisions on a pre-insolvency moratorium that would not only suspend a duty to file and acts of enforcement, but also limits the ability of contracting parties to modify contracts based on default rights.
- 4 Lastly, there should be support for the livelihood of entrepreneurs and their employees. For small businesses that are not able to raise their levels of debt, the “hibernation” of the business does not provide for the livelihood of the entrepreneurs and their employees. They are without income for weeks, possibly months. Here, state aid initiatives must include both employees of such businesses and their directors or entrepreneurs.

Courts and legal advisors play an important role in providing a solid insolvency framework to businesses these times. Many jurisdictions announced that courts are limitedly available and will deal with urgent cases only. Many times, insolvency related cases will qualify as such. Still, in taking measures amending insolvency legislation, policy makers must be aware of the scarcity of courts and the limited resources in many judicial systems to introduce means of virtual communication. Larger advisers and law firms have formed multidisciplinary teams or set up separate help desks to advise businesses in times when they require adequate legal and business advice to restore their solvency. Given these extraordinary economic conditions, the Executive of CERIL has made a plea to legal business advisors to apply a reduced fee-structure appropriate for the extraordinary situation that businesses find themselves in if possible. Legal advisors will benefit in the long run when vital companies remain and do not go under.

4 | $E = MC^2$

The speed of change we face in our new global economic reality is unprecedented. The outbreak of the COVID-19 virus and social distancing policies imposed by governments, such as ours in Germany and the Netherlands, include economic distancing and accept the consequence of a recession. Still, any legislative response must, firstly, aim at preventing unnecessary bankruptcies due to government intervention and market failure. Based on such emergency legislation, secondly, legislators should revisit their restructuring and insolvency frameworks and institutions. In the aftermath of COVID-19, businesses will carry a new debt structure that will probably include larger amounts of (state aid) loans. They will need to test whether this debt burden is sustainable in market modified by the virus. The foreseeable need for debt reductions in many businesses can only be covered by viable restructuring and, where necessary, insolvency frameworks and, possibly, statutory debt relief initiatives.

Again, as at the outbreak of the virus, it is important to meet the aftermath of lockdown measures swiftly in order to minimise unnecessary bankruptcies. As in Albert Einstein's famous formula $E = mc^2$, or in plain language: energy is mass times speed of light (squared), the legislative challenges could be framed by stating that the potential of today's business structures (energy) in any jurisdiction is best preserved when the right legislative measures (mass) are effective timely (speed). Lawmakers should refocus and stay alarmed. Businesses all over the globe depend on it.

Stephan Madaus¹
Gert-Jan Boon²

¹*Civil Procedure and Insolvency Law, Martin-Luther Halle-Wittenberg University, Halle, Germany*

²*Leiden University, Leiden, The Netherlands*

Correspondence

Stephan Madaus, Civil Procedure and Insolvency Law, Martin-Luther Halle-Wittenberg University, Halle, Germany.
Email: stephan.madaus@jura.uni-halle.de

ENDNOTES

¹See for more information on CERIL: www.ceril.eu.

²The statements (sometimes accompanied by a report) are available at: www.ceril.eu/statements-and-reports.

³CERIL Executive Statement 2020–1 on COVID-19 and Insolvency Legislation (March 20, 2020), available at: <https://www.ceril.eu/news/ceril-statement-2020-1>. The Reporters for this Statement were Professor Stephan Madaus and Emeritus Professor Bob Wessels, assisted by Gert-Jan Boon as the Associate Researcher.